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April 6, 1998

The Honorable John M. McHugh
Chairman, Subcommittee on the Postal Service
Committee on Government Reform and Oversight
U.S. House of Representatives
2157 Rayburn House Office Building
Washington, DC 20515-6143

Dear Chairman McHugh:

Thank you for the opportunity to respond to the proposed revisions to H.R. 22, the Postal Reform Act of 1997, prior to your moving forward on the bill. I have **enclosed the** Greeting Card Association's (GCA) detailed comments on a disk in WordPerfect as you requested.

The GCA stands apart in representing the citizen mailer in postal issues, both from a legislative perspective and in postal rate cases. In reviewing H.R. 22, as revised, we want to make comments about four issues. Let me highlight them here.

Our most pressing concern involves the bifurcation of First Class mail between single piece mail and the rest of First Class mail. The GCA firmly believes this separation into baskets would result in higher rates for the single piece "**subclass**" in the future. The simulation model, which the GCA used in the reclassification case, validated this expectation, and the Postal Rate Commission refused to create such a subclass.

Our concern is mirrored in the Postal Service's own testimony in the current rate case. Witness Peter Bernstein compares the difference in the cost of a single piece letter and a discounted workshare letter after applying Ramsey pricing -- the result is a 40% increase for single piece mail. The relevant chart appears on page 87 of USPS T-31.

Secondly, the GCA believes that labor costs -- a critical area that has been mostly overlooked in postal reform -- would be a more appropriate subject for study than universal service, which is fundamental to binding the nation together.

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Next, the GCA wishes to compliment you and your staff for strengthening the rate cap provisions. The provisions in the revised bill are an improvement. We continue, however, to urge you to include safeguards to ensure that the cap is truly a cap, which protects the citizen mailer against any increase greater than inflation.

And last, we strongly favor the increased authority you have given the Postal Rate Commission in your proposed revisions. This independent body provides an enormously critical watchdog for all users of the mail.

The GCA commends you on your persistence in attempting to find the best path for postal reform. You have made a Herculean effort toward reconciling the complex differences presented by the many constituencies of the USPS.

Sincerely,

A handwritten signature in black ink, appearing to read "Marianne McDermott", with a stylized flourish at the end.

Marianne McDermott
Executive Vice President

Enc.

SPECIFIC COMMENTS FROM THE GREETING CARD ASSOCIATION

WHY LEGISLATIVELY DIVIDING FIRST CLASS MAIL INTO TWO "BASKETS" IS LIKELY TO HARM THE CITIZEN MAILER

The proposed revision of H.R. 22, while improved in several respects, still divides **"non-competitive"** mail into four **"baskets"** -- and: most objectionably, divides the historic First Class category into separate bulk and single-piece baskets. This approach is both unjustified on the general theory of the legislation and harmful in its results.

The new proposal calls for a more clean-cut form of price-cap regulation than did earlier versions; in particular, it envisions substantially restricting the **"X"** adjustment in the price-cap formula (index minus **"X"**) to the role of a **productivity** adjustment. Thus, once rates have been escalated above the level set in the baseline case, neither USPS-specific costs nor the particular functional or demand characteristics of the **different types** of mail would have a role in establishing maximum rates: the price index is unrelated to postal operating costs, and the productivity adjustment is not inherently associated with different types of mail.

Under these circumstances, there appears to be no good reason related to the price-cap structure, to divide non-competitive mail services among multiple baskets.

Assuming for argument's sake, however, that it would be legitimate to divide non-competitive mail along broadly functional lines, there is clearly no reason to divide First Class again, into bulk and single-piece baskets. The **purpose of First-Class letters is** the same whether they are sent one at a time or in a mailing of 500,000: to convey a message of some kind from one person or organization to **another**.¹ This purpose is functionally distinct from that of a Periodical (to distribute bound, recurrent collections of editorial and advertising to readers who have bought or ~~requested them~~), or of Standard Mail (to convey any mailable object, with or without message content and whether or not requested or expected by the recipient). But this argument provides no justification for a subdivision within First Class Mail.

¹For example, a solo practitioner's law office mailing ten bills to clients each month is using the mails for precisely the same purpose as a bank mailing 2,000,000 (presorted, barcoded, and bulk-entered) bills to credit card holders.

In particular, the proposed distinction between bulk and **single-piece** First Class mail lacks any colorable basis other than a difference in cost. Given the purposes for which the baskets are proposed to be created, however, this distinction is irrelevant.

First, price cap regulation seeks both to hold the enterprise to a reasonable maximum level of secular cost increase (qualified so as to recognize -- and elicit -- productivity gains) and to reward it for better-than-expected efficiency. To do this, it explicitly puts aside the traditional tie between cost of service and rates. Consequently, there is no reason in setting up a price cap scheme to separate classes of service on the basis of present unit **cost to serve**.

Second, under the present structure of postal rate regulation, the **Postal Rate** Commission and the Governors have demonstrated capacity and willingness to recognize cost differences through discount rates. In **that** way, cross-subsidy has been avoided, worksharing is efficiently² fostered, and costs are efficiently recovered. Such discounts would continue even in a price cap system. No legitimate claim of bulk mailers for their worksharing activities to be compensated out of savings to the Postal Service would be disregarded in fixing rates within a single First Class basket.

It is not clear from the material so far made available to describe the proposed legislation whether the required baseline rate case would be conducted on the basis of separate bulk and single-piece First Class costing categories (i.e., what are now designated as "subclasses") in order to initiate the two-basket structure in the base rates even before the beginning of price-cap regulation. If this were required -- or if the Postal Rate Commission were persuaded to restructure First Class Mail in that way -- the **long-term** effects would be particularly undesirable. For once that distinction had been built into the final **cost-based rate** proceeding, there would be no way to correct the resulting misallocation of institutional costs in the future. Ratemaking following the baseline case would be largely independent of USPS costs and would, by statute, be done separately for bulk and single-piece mail. This structure would simply perpetuate the improper division first made in **the baseline case**, and citizen mailers would continue to feel the impact into the foreseeable future.

²Worksharing is efficiently promoted when the discount is set at no more than the Postal Service saves as a result of the worksharing. When that is true, mailers who can perform a type of work (e.g., sorting) at less than the Postal Service's cost per piece have an incentive to do so, while those whose cost would be greater than the Service's have an incentive to let the Service perform it.

In fact, at whatever stage it might be carried out, the project of artificially dividing First Class into two baskets is reminiscent of the effort -- rejected by the Postal Rate Commission in Docket **MC95-1** -- to grant separate subclass status to automated bulk First Class **mail**, despite the absence of any difference in demand (i.e., same price elasticity for automated and single-piece mail). The effect of that subdivision would have been to shift the assignment of institutional costs of the Postal Service onto single-piece mail.' As pointed out above, creating such a division by means of the baseline case would make the legislation an even more formidable vehicle for achieving this undesirable effect -- with no means of undoing it once the damage became apparent. And, as shown earlier, even if it were created only after the baseline case, the division of First Class into two baskets makes no sense from the standpoint of price-cap theory or of the social and economic function of the mail.

Such disproportionate taxing of institutional costs to single-piece letters cannot be justified in view of the social purpose of the USPS' letter-mail monopoly: binding the Nation together "through the personal, educational, literary, and business correspondence of the people.*" As has long been the case, mail classes -- and their attendant differences in institutional-cost tax -- are to be separated only when and if the mails concerned differ as to the purpose for which they are sent, the type of sender, and the content of the mail. These criteria for establishing mail groupings for assignment of markups are consistent with the goal of maximizing the social benefits the Postal Service confers. It is that social benefit that undergirds the postal letter monopoly and that should be the basis for decisions regarding recovery of institutional costs. Where there is no distinction in purpose or content, there should be no distinction in the way rates are set -- under the present system of ratemaking, or under one based on price-cap techniques.

³**This** would have occurred because, as a separate subclass, bulk-entered automation mail would have a lower **attributable** cost **that the** other resulting ("**retail**") subclass: and -- assuming that, as in the past, institutional costs were added through a percentage markup -- the lower attributable cost would imply a smaller contribution to institutional costs for the same markup fraction. By contrast, establishing rate discounts on the basis of per-piece savings properly compensates the worksharing mailer without reducing its (absolute) contribution to institutional cost.

'Postal Reorganization Act, §101(a) [39 U.S.C. §101(a)].

Division of First Class Mail into two baskets would lead to an uneconomic and socially detrimental increase in the taxing allocation of costs to single-piece letters -- at a time when the Postal Service should be considering how to retain⁵ that mail. "Aunt Minnie," the Postal Service, and the nation as a whole would be harmed.

WHY A STUDY OF UNIVERSAL SERVICE IS UNDESIRABLE AND A STUDY ON LABOR COSTS IS NEEDED

The newly-proposed study and **"quantification"** of universal service is undesirable for a number of reasons. First, there is no apparent need for it. Existing postal services have been developed in a fundamental context of universal availability and are adapted to that form of public service. Investigating which of them are needed **"in order to fulfill the universal service commitment"** is hardly necessary - unless the ultimate aim is to privatize some classes of mail. The proposed proceeding would be inordinately expensive, and - in part because the analogy to FCC inquiries under the 1996 Telecommunications Act is seriously flawed - might well produce no usable results. The ultimate questions respecting universal service, moreover, are essentially legislative rather than administrative (as the revisions tacitly recognize, by making the **PRC's** report subject to Congressional review).

While the proposals, like H.R. 22, make elaborate revisions in the mechanisms for distributing and recovering costs from mail users, they still lack serious proposals for controlling costs. A program of incentives to contain operating costs will not be effective as long as the managers concerned have countervailing incentives to leave things as they are. The revisions do not address this problem. A study devoted to controlling labor costs would be a better use of funds than one devoted to universal service.

STRENGTHENING THE RATE CAP PROVISIONS AND EFFORTS TO PREVENT CROSS-SUBSIDIZATION BY SEPARATING COMPETITIVE AND NONCOMPETITIVE SERVICES

The GCA applauds the serious effort made to prevent **cross-**subsidization at the expense of captive customers, **by** separating competitive from noncompetitive postal services. The proposed changes to H.R. 22 would require the USPS's competitive postal services to be financed by a separate fund in the Treasury; the present Postal Service Fund would be reserved for noncompetitive services and could not be "raided" to pay for losses on unsuccessful competitive products or those which cannot be sold at

⁵Both proposed First Class baskets of course ~~fall~~ within the **"non-competitive"** category. But the Postal Service itself admits that even letters subject to the monopoly can be diverted into nonpostal media. This is at least as true of single-piece letters as of those entered in bulk.

a compensatory rate. While the proposals to separate the competitive and noncompetitive categories may contain some loopholes, they represent a significant effort to prevent **cross-subsidization** and should be pursued further. A related change, the restriction of volume discounting to mail services in the competitive category, would also be an improvement.

Provisions governing the productivity adjustment have been improved. Unlike H.R. 22, which called for adjustment factors based on criteria having little or nothing to do with productivity - in particular, relative demand - the revisions seek to establish a true productivity adjustment. This is consistent with the theory, and the customary practice, of price-cap rate regulation. The revisions also improve on H.R. 22 by placing limits on the possibility of a positive adjustment, which would allow the rates for some or all classes to increase faster than inflation.

REVISED PROPOSALS RETAIN PRESENT **RATEMAKING** CRITERIA IN BASELINE RATES

Earlier proposals would have established baseline rates in a special proceeding in which the ratemaking standards enacted in 1970 and 1976 would be dropped and a new set - emphasizing relative demand or **"what-the-traffic-will-bear"** pricing - would be substituted. The new proposal would keep the existing standards, which more adequately reflect the needs and interests of all users of the mail. (It would still be worth investigating whether a new framework could not be simply superimposed on a basis of existing rates - which already reflect the current ratemaking criteria).

RECOGNITION OF THE VITAL ROLE OF THE POSTAL RATE COMMISSION AND INITIATIVES TO IMPROVE ITS EFFECTIVENESS

The revisions provide for a broader range of final actions - subject to judicial review - by the independent **"Postal Regulatory Commission."** These include actions on some international rates, on decisions for or against allowing a positive adjustment factor, and determinations of the competitive status of a postal service. If a rate complaint before the PRC is successful, the PRC could act-ually ~~adjust~~ **adjust** rates **rather than making a recommendation to the** postal Directors. Even where the Directors act on their own, as in setting actual prices under the cap, judicial review is provided for in the revisions.